

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

10 Civ. 457 (GLS)
(DRH)

McGINN, SMITH & CO., INC.,
McGINN, SMITH ADVISORS LLC,
McGINN, SMITH CAPITAL HOLDINGS CORP.,
FIRST ADVISORY INCOME NOTES, LLC,
FIRST EXCELSIOR INCOME NOTES, LLC,
FIRST INDEPENDENT INCOME NOTES, LLC,
THIRD ALBANY INCOME NOTES, LLC,
TIMOTHY M. MCGINN; AND
DAVID L. SMITH,

Defendants, and

LYNN A. SMITH,

Relief Defendant.

**FIRST REPORT OF THE
RECEIVER**

The First Report of the Receiver is filed pursuant to the Order to Show Cause, Temporary Restraining Order and Order Freezing Assets and Granting Other Relief dated April 20, 2010 (Docket No. 5) (“TRO”).

INTRODUCTION

Following the signing of the TRO by this Court on the afternoon of April 20, 2010 and my appointment as Receiver, I proceeded at approximately 3:30 p.m. to what I understood to be the Albany, New York business premises of the 82 MS Entities (as defined in

- 2 -

the TRO). When I arrived, federal law enforcement officials were still in the process of executing a search warrant.

I was accompanied by two paralegals and one attorney from my counsel, Phillips Lytle LLP. Acting under my direction, they assisted me that evening in undertaking several tasks until approximately 9:00 p.m. including (i) identifying the names, contact information and functions of the employees who were still on-site, (ii) photographing and taking a very generalized inventory of the documents in each office and file cabinet, (iii) changing the door locks with the assistance of a locksmith, and (iv) inspecting two floors in the building to ascertain if valuable information or property was not secure. We came to learn that most of the current documentary information had been removed as part of the search warrant process that day.

At the same time, I met with several of the employees including the Controller and in-house counsel to try to understand cash flow, bank accounts, material asset locations, and payroll and other short-term needs. Since there are 82 MS Entities (as listed on Exhibit A to the TRO), my focus was on primarily attempting to make sure where the largest amounts of cash were located. I had virtually no prior information about the MS Entities prior to arriving at the Albany premises. I was informed that cash flow was “tight” and multiple litigations and arbitrations were pending in various stages and needed to be dealt with. I spent time communicating that evening with one bank in particular where a significant amount of checks approximating \$200,000 were in float for payment to third parties. We were successful in securing confirmation that evening that the account had been effectively frozen.

- 3 -

The essential business operation at the Albany office is the so-called Alarm Traders business, which services thousands of primarily residential alarm contracts and earns fees in doing so. I was informed that evening that other MS Entities operated in a more or less independent manner (including Benchmark Communications LLC and White Glove Cruises LLC which operate in Louisiana and Florida, respectively).

The following day was spent almost entirely dealing with the frozen bank accounts, issued credit cards, and cash flow and payroll issues. I also met briefly with defendant David Smith and requested a meeting with him and Timothy McGinn as soon as possible to ascertain their perspective on the operating businesses and near-term critical items which could be difficult for me to independently ascertain given the decentralized and what appeared to me initially as a somewhat “informal” management system. While on the premises that day, I came upon an employee preparing a Form D for filing with the SEC. I would not authorize the continuation of the process.

Access procedures to the premises were changed to provide for improved security including the use of a single office door for access. Additionally, a Phillips Lytle receptionist was stationed at the premises, and a sign-in and sign-out sheet process was implemented until a Sonitrol electronic card system was installed last Friday. Satellite business and record locations were also identified. Significant storage facilities in Clifton Park, New York were secured and some offices under construction were inspected. I met with the employees and explained my role and the procedures which would be followed in the continuing operation of the non-broker dealer businesses.

- 4 -

Considerable time was spent meeting with the principals of Pine Street Capital Partners LP and their counsel to understand their business and its upcoming decision points.

In the midst of attempting to gather enough information to be aware of critical facts, each of the businesses still needed to function on an ongoing basis with limited staff to accomplish both efforts.

On the evening of Sunday, April 25, I met with David Smith and Timothy McGinn and their counsel for the purpose of obtaining an explanation of the assets and liabilities of the operating entities and the identification of short-term critical needs and risks.

BUSINESS OPERATIONS

1. General

The next several weeks were spent in trying to bring some normalcy and routine to the remaining operating businesses which include Alarm Traders (an alarm service business), so-called “triple play deals” on the U.S. Gulf Coast such as Benchmark (cable television, Internet and phone services at condominiums and apartment buildings), and a Florida travel agency (White Glove Cruises LLC) by (a) requesting the preparation of 90-day cash flow projections; (b) obtaining confirmation as to bank accounts and balances and working through procedures with each of their banks, (c) conferences to learn about the businesses, operations and history, and (d) reviewing and approving each gross payroll and vendor payment request. In general, payments to insiders and investors were not approved. Significant time was spent terminating credit cards, dealing with individual requirements of each depository bank, and communicating on a daily basis with management employees as “new” emergency situations seemed to arise daily. It appears that all gross payroll and taxes have been paid based upon information provided

- 5 -

to me to date. Critical vendor payments have been made, and a process towards paying payables once per week is being established.

2. McGinn, Smith & Co., Inc.

This is the registered broker dealer entity and a defendant in this action. It ceased essential operations in December 2009 when its business was acquired by DLG Wealth Management in Clifton Park, New York. Remnants of this business, however, remain as recurring liabilities including several employees, vendor payments and other claims. There are, for example, shared services between certain of the McGinn Smith entities and Alarm Traders which have historically not been broken out. The embedded and recurring McGinn Smith costs need to be dealt with because there is not sufficient money on hand to pay those liabilities which to some degree cross over to other MS Entities such as Alarm Traders.

3. Cruise Charter Ventures, LLC d/b/a YOLO Cruises

I learned shortly after my appointment that a deposit of \$88,560 had not been made to Carnival Cruise Lines in February 2010 as required for a prearranged Halloween weekend "lifestyle" charter pursuant to an August 14, 2009 charter agreement. Carnival Cruise Lines, the counterparty for the lifestyle charter, sent a default letter shortly after entry of the TRO. The default put at risk a YOLO deposit of \$425,000 already in place with Carnival. The Receiver's counsel requested Carnival to withdraw the default letter based on the stay provided in the TRO. Carnival agreed to withdraw the default letter reserving its rights, and settlement negotiations ensued. Carnival and the Receiver reached an agreement to terminate the lifestyle cruise contract. The cruise was significantly undersubscribed, and, in my judgment, represented a significant financial and reputational risk. The estate was at risk of not only having to pay the

- 6 -

additional \$88,560 past-due deposit but up to approximately another \$171,000 for potential underbooking penalties to Carnival. Although Carnival was entitled to keep the entire deposit and to assert claims for greater amounts from YOLO, following several days of negotiation, Carnival agreed on May 10, 2010 to return to the Receiver \$222,397.41 in return for the right to cancel the charter contract. Carnival also released the Receiver and the estates. A determination needs to be made as to if and when to return deposits to the limited number of cruise customers because it appears other MS Entities may have funded YOLO's operation.

4. Bank Accounts and Cash on Hand

There are a significant number of open bank accounts (confirmed so far) in at least four financial institutions. New accounts have been opened under the Receiver's name and sole signature authority while the existing accounts remain frozen.

At the time of the Receiver's appointment, total bank account balances (not including some remote business operations whose bank accounts were not immediately visible to the financial staff in Albany, New York) were \$485,491.63. As of June 2, 2010, the balances at those same accounts totaled \$750,763.38 plus the Carnival settlement payment of \$222,397.41. These balances do not take into account timing differences for payment of payables.

An additional \$3,278.655.40 has also been received post-TRO as a result of a loan payoff at a Pine Street Capital Partners LP portfolio company. A portion of these proceeds would be due to Pine Street's investors which include the Relief Defendant and the David and Lynn Smith Trust.

INTERIM EVENTS

1. Cash Flow Projections. I received cash flow projections from various operating entities as requested. The purpose was to assure that the businesses were operating on at least a cash flow neutral basis. Operations have essentially continued on that basis.

2. Employees and Staff. Two employees (who are related to the defendants) resigned. One employee who was not performing any material current functions was terminated. A review is underway to identify how to utilize remaining employees with an eye towards minimizing costs. Prior to my appointment, former McGinn Smith brokers were continuing to be paid commissions. That practice has ceased.

3. Benchmarking and Best Practices. I requested Alarm Traders to begin to benchmark against industry standards its performance in terms of customer calls received, waiting time, attrition. The account receivable and customer termination practices for customer non-payment have been accelerated. At my request, the staff is also conducting a current inventory of the several thousand alarm contracts purchased in mid-April 2010 in the so-called "Firstline" transaction. These contracts were physically delivered post-TRO but were never inventoried after their arrival.

4. Leased Premises. On the second day of my Receivership, I met with the Albany landlord's agent to review occupancy terms and status of the occupancy in Albany, to advise the landlord's agent of my role and function, and to request copies of the existing leases. I informed the landlord of the change of locks and access to the premises. The landlord's agent declined to accept keys to the premises and instead arranged for the cleaning service to come before the business closes each day. The landlord requested that the McGinn Smith trash including used

- 8 -

office furniture, computers, monitors and paper files that were in the third and fifth floor hallways be removed. The clean-up has since been accomplished. Most of the items were generated from the move by McGinn Smith from the building's fifth floor and in its attempt to move to Clifton Park. All surplus equipment formerly in the hallways and on the fifth floor has been inventoried and, if capable of being moved, has been removed to a secure location or otherwise trashed or recycled, as appropriate.

5. Other Real Property Interests. As part of my due diligence process, I learned that the Receiver has an interest in at least three parcels of non-residential real property. They include the Century Imaging facility in Latham, New York, which is a two condominium vacant commercial building in deteriorating condition. I have inspected the property and found abandoned material on site. I am in the process of studying its legal situation since the estate appears to be subordinate to a senior mortgage and significant real estate taxes. The second property is the Seton Hall Medical Office Building in Troy, New York. Communications have been established with a potential buyer who, this week, has requested a meeting with me to discuss the legal and financial status of the building with an eye towards acquisition. The property needs better management and the possible infusion of capital. The third property is a local hotel which is in foreclosure proceedings. I am considering the best approach to these property interests.

6. Accountants. I have preliminarily retained Chiampou Travis Besaw & Kerschner LLP ("Chiampou Travis"). Chiampou Travis spent one day on site interviewing the Controller and his assistant as to cash flow, assets and accounting practices. As a result of that session, it was agreed that the Controller's recommendations for ongoing cash flow procedures were

- 9 -

satisfactory and that further accounting steps would be taken once the Receivership was out of its gap period, assuming a preliminary injunction order and a continuing Receivership Order were entered. I reached that conclusion based upon the limited cash presently available to the estate and in an attempt to maintain the status quo to the extent that it was not materially detrimental to the Receivership estates.

7. Compilation of Important Business Records. During this period, the financial staff at my request has prepared lists of transfers made within the last 120 days to allow me to assess the potential voidability of any such transfers including payments. The staff is also preparing at my request a list of amounts due from former McGinn Smith brokers which, at least in several cases, constitute material amounts. There had not been a regular practice of collecting these amounts, and they remain unpaid including one dating back to as early as 2002.

TASKS IN PROCESS

The financial staff need to:

1. Bring all financial records up to date – the books of account are not current and need to be brought up to date.
2. Reconcile all bank accounts for the pre-Receivership period.
3. Complete the 120-day transfer charts for some entities whose accounts are not readily accessible.
4. Develop a plan for filing extended and possibly past-due tax returns and identifying refund possibilities.

- 10 -

The Receiver has an extensive list of projects to complete considering the circumstances including:

1. Complete asset and liability estimates and an analysis of how to best monetize value for investors and creditors.
2. At this time, it is premature to file any bankruptcy petitions, but consideration of that alternative will continue.
3. Continue to meet and communicate with significant borrowers or persons owing money to the Receivership estates including former brokers. Two accounts aggregating in excess of \$1 million may need to be sued in the very near term if prompt agreements cannot be reached.
4. Complete the identification of all lenders which has been an ongoing process. Some lenders identified to date are unsecured while others have collateral for their claims. Investigations will continue and will be presented in greater detail in the next several Reports once all documents are gathered and the bona fides of the transactions assessed.
5. Determine to what extent external accounting firm assistance is needed and justified.
6. Identify and understand the more remote business investments. The check writing function is in the process of being centralized in Albany at my request.
7. Complete the assembly and organization of all corporate documents for the MS Entities. This project is nearly complete.
8. Finalize an investor and entity list for communications with investors and the establishment of a potential claims process.

- 11 -

RETAINED PERSONNEL

Phillips Lytle LLP has been engaged to represent the Receiver, and Chiampou Travis has been engaged to provide accounting advice.

COMMUNICATIONS

1. The Receiver established a website (www.mcginnsmithreceiver.com) as a means of communication with investors and other parties at the start of the Receivership. Pleadings and other information have been and will be posted there as events evolve. I intend to send a letter with general information to all investors in the next few weeks once facts are more certain.

2. IRA's – It appears that some parties may not have had their IRA transfers completed. The Receiver is attempting to work out a process to have this completed without cost to the estates if possible.

3. Call Logs – A log of all investor calls and messages is being maintained.

Dated: June 4, 2010

/s/ William J. Brown
William J. Brown, Esq.
Receiver